IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

NO. 627.

In the Matter of
PITTSBURGH TERMINAL COAL CORPORATION,
Debtor.

ALEXANDER GUTTMANN, Individually and as Chairman of the Protective Committee for Preferred Stockholders of Pittsburgh Terminal Coal Corporation, HOWARD S. GUTTMANN, IRENE GUTTMANN, RUDOLPH GUTTMANN, MONROE GUTTMANN and ELIZABETH WOLFERS,

Petitioners,

v.

PITTSBURGH TERMINAL COAL CORPORATION, Debtor; WILLIAM G. HEINER, as Trustee of Pittsburgh Terminal Coal Corporation, Debtor; THE UNION TRUST COMPANY OF PITTSBURGH, Successor Trustee for Bondholders of Pittsburgh Terminal Coal Corporation; THE PITTSBURGH AND WEST VIRGINIA RAILWAY COMPANY; and NORTH AMERICAN COAL CORPORATION,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI.

WILLIAM H. ECKERT,
Counsel for The Union Trust Company of Pittsburgh, Successor Trustee for Bondholders of Pittsburgh Terminal Coal Corporation.

1025 Union Trust Building,
Pittsburgh, Pennsylvania.

SMITH BROS. CO. INC., LAW PRINTERS, 434-436 BOULEVARD OF ALLIES, PITTSBURGH, PA.

SUBJECT INDEX.

TABLE OF CITATIONS.

Cases.

Statutes.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

NO. 627.

In the Matter of
PITTSBURGH TERMINAL COAL CORPORATION,
Debtor.

ALEXANDER GUTTMANN, Individually and as Chairman of the Protective Committee for Preferred Stockholders of Pittsburgh Terminal Coal Corporation, HOWARD S. GUTTMANN, IRENE GUTTMANN, RUDOLPH GUTTMANN, MONROE GUTTMANN and ELIZABETH WOLFERS,

Petitioners,

v.

PITTSBURGH TERMINAL COAL CORPORATION, Debtor; WILLIAM G. HEINER, as Trustee of Pittsburgh Terminal Coal Corporation, Debtor; THE UNION TRUST COMPANY OF PITTSBURGH, Successor Trustee for Bondholders of Pittsburgh Terminal Coal Corporation; THE PITTSBURGH AND WEST VIRGINIA RAILWAY COMPANY; and NORTH AMERICAN COAL CORPORATION,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI.

COUNTER-STATEMENT OF THE CASE.

Petitioners complain of the affirmance by the Circuit Court of Appeals for the Third Circuit (R. 82) of an order entered by the United States District Court for the Western District of Pennsylvania (R. 79) dismissing exceptions to and confirming the orders of the Hon-

orable Watson B. Adair, Referee in Bankrupcty, filed September 12, 1941, disallowing the petitioners' claims as creditors of the Pittsburgh Terminal Coal Corporation, without prejudice to their rights to prove interests as stockholders (R. 66-69).

On December 4, 1939, a petition was duly filed in the District Court under Chapter X of the Bankruptcy Act for the reorganization of the Pittsburgh Terminal Coal Corporation, hereinafter commonly referred to as the Debtor (R. 1). On January 2, 1940, the District Court approved the petition as properly filed and appointed trustees for the Debtor (R. 1). This proceeding, designated in the District Court as No. 20,716 in Bankruptcy (R. 1), is still continuing and it was in this proceeding that the claims of the preferred stockholders in question were filed.

The Debtor has outstanding bonds in the principal amount of $2,564,000 (first report of Heiner, Trustee, p. 2)[1]. These bonds are secured by a first mortgage on real estate of the Debtor, and The Union Trust Company of Pittsburgh has succeeded as trustee for the bondholders under said mortgage indenture (first report of Heiner, Trustee, p. 2). The Debtor also has outstanding 31,285 shares of preferred stock and 119,000 shares of common stock (first report of Heiner, Trustee, p. 1). The Debtor lost money in every year beginning with 1927 (first report of Heiner, Trustee, p. 4). The Debtor's balance sheet as of November 30, 1940, showed a capital deficit of $2,475,293.04 (R. 27). "From an examination of the balance sheet and the foregoing comments on assets and liabilities, it is readily apparent

---

1. This report, which is dated January 29, 1941, is included in the certified record on appeal, being item 32 in the petitioners' Designation of Contents of Record on Appeal.

that the debtor is heavily insolvent" (first report of Heiner, Trustee, p. 11).[2]

On October 3, 1940, the District Court ordered, *inter alia,* that "All proofs of claim, except proofs of claim founded on bonds and proofs of interest founded upon shares of stock, shall be filed on or before November 18, 1940, and objections to such claims shall be filed with the Referee on or before December 3, 1940."[3] The same order provided that the Referee should allow or disallow all contested claims. No date has yet been fixed for the filing of proofs as stockholders and such interests can still be proved.

On November 18, 1940, proofs of claim were filed by the petitioners, which were amended on July 18, 1941, and again on August 5, 1941 (R. 53). The original claims, as well as the amendments thereof, are all substantially alike (R. 65). All of the claims are based on instruments which are distinctly labeled preferred stock certificates (R. 34, 44, 54). The claims recite that a copy of one of the instruments on which the claims are based is attached to them (R. 34), but since no copy of said instruments has been printed in or attached to the record

---

2. In the second report of Heiner, Trustee, included in the Record on Appeal through this respondent's Counter-designation of the Contents of the Record, it is stated (p. 2) that mining operations by the Debtor have completely ceased; the conclusion of Messrs. Sanderson & Porter, engineers who made a thorough study of the Debtor, is quoted (p. 3) that no reorganization of the Debtor on a profitable basis is possible; and the Trustee expressed himself as follows (p. 3): "It appears, consequently, that no reorganization of the Debtor's assets on a going concern basis (mining operations) can be effected at this time and that the immediate function of this proceeding is to provide the means for the orderly liquidation of the assets and their appropriate distribution among the creditors and stockholders."

3. Said order of October 3, 1940, is item 10 in petitioners' Designation of Contents of Record on Appeal.

printed by petitioners, we are inserting at this point a photostatic copy of one of those instruments, being Certificate N.Y.O. 4436, issued to Monroe Guttmann, one of the claimants, and referred to in his amended proof of claim (R. 45). The instruments are all the same, except for the serial number, amount of shares and name of the person to whom issued (R. 34). Said instruments being in writing will speak for themselves and will be found to have all the earmarks and distinguishing characteristics of shares of preferred capital stock, and none of those of certificates of indebtedness or bonds. The claims assert that the instruments on which they are based are certificates of indebtedness and allege that the Debtor is indebted to the claimants in the amount of the par value of the preferred stock held by each of them, respectively, plus the accumulated dividends thereon (amounting together to $170.50 a share), a preference for which is claimed to the extent of $39.97 a share (R. 33, 35). The Debtor promised to deposit 7¢ for each ton of coal mined into a sinking fund for the retirement of the preferred stock (see paragraph 5 of the endorsements on the preferred stock certificate), and the amount of the preference claimed is apparently calculated by dividing the number of preferred shares into the amount which would have been in the sinking fund if it had been maintained in accordance with the aforesaid provision (R. 35-36). In fact the last payment into the sinking fund was made in March, 1928, and no sinking fund whatsoever for preferred stock now exists (R. 21-23, 62 and see first report of Heiner, Trustee, p. 2). No dividends on the preferred stock have been declared or paid since March 1, 1927 (first report of Heiner, Trustee, p. 2).

Objections to the claims on the ground that the claimants were preferred stockholders and not creditors


INCORPORATED UNDER THE LAWS OF
THE COMMONWEALTH OF PENNSYLVANIA
NUMBER
SHARES
SHARES $100 EACH
SHARES $100 EACH
PITTSBURGH TERMINAL COAL CORPORATION
This Certifies that -MONROE GUTTMANN-
is the owner of TEN shares of the
fully paid and non-assessable Preferred capital stock of this Company, of the par value of One Hundred Dollars
($100.00) each, transferable on the books of the Company only by the holder hereof in person or by duly authorized
CANCELLED
This certificate is not valid until countersigned by the Transfer Agent and registered by the Registrar.
In Witness Whereof the said Pittsburgh Terminal Coal Corporation has caused its corporate seal to be hereunto
affixed and this certificate to be signed by its duly authorized officers this JAN 14 1937

STATEMENT OF THE PREFERENCES, VOTING POWERS, RESTRICTIONS AND OTHER PROVISIONS GOVERNING THE SIX PER CENT. CUMULATIVE PREFERRED STOCK, AND THE COMMON STOCK.

1. The holders of the preferred stock of this company shall be entitled to receive, as and when determined and declared by the Board of Directors, dividends at the rate of 6% per annum, and no more, payable quarterly on the first day of each of the months of March, June, September and December of each year, for the quarter immediately preceding, from the surplus or net profits of the corporation. The said dividends shall be cumulative; and no dividends shall be paid or set apart for the common stock in any calendar year, unless and until full dividends at the rate of 6% per annum for such calendar year shall have been declared and paid on the preferred stock, or provided for by a fund set apart for the payment thereof, nor unless and until full dividends shall have been paid on the preferred stock for all previous years, or portions thereof.

2. When full cumulative dividends on the preferred stock at the rate of 6% per annum shall have been declared for the current year and shall have been paid or provided for as aforesaid, the Board of Directors may, in its discretion, declare dividends on the common stock of the corporation at such rate as may, from time to time, be determined by said Board of Directors, payable then or thereafter, out of any remaining surplus or net profits of the corporation.

3. In the event of any liquidation or dissolution of the corporation, whether voluntary or involuntary, the holders of the preferred stock shall be entitled to be paid in full, both the par amount of their stock and the dividends accumulated and unpaid thereon, before any amount shall be paid to the holders of the common stock, but shall not be entitled to share further in the assets of the corporation or the proceeds of liquidation. After the payment to the holders of the preferred stock of its par value, and the unpaid accrued dividends thereon, the remaining assets and funds of the corporation shall be distributed and paid to the holders of the common stock according to their respective rights.

4. The holders of the preferred stock shall not be entitled to receive any dividends or share of the profits beyond the 6% aforesaid, whether payable in cash, stock or property; nor shall they have any preemptive right to subscribe for any new issue of stock of any class, now or hereafter authorized or issued; and the corporation reserves the right, without any notice to, or consent of, the then holders of any of the preferred stock of this corporation, to increase or alter in any way the amount and character of the common stock which it may be authorized to issue. Additional preferred stock of equal or superior standing with that then outstanding shall not be issued except upon the affirmative vote of the holders of at least two-thirds in amount of the outstanding preferred stock and of at least two-thirds in amount of the outstanding common stock, registered at an annual meeting of the stockholders, or at a special meeting of the stockholders called in compliance with the provisions of the By-Laws relating thereto, and of which meeting notice is given to the holders of the preferred stock, similar to that given to the holders of the common stock. In no other respect may the rights or terms of the preferred stock be altered or affected except upon favorable vote of a majority of the preferred stock.

5. A sinking fund for the protection and gradual retirement of the preferred stock shall be created by the deposit, within thirty days following the termination of each quarter of the calendar year, with a bank or trust company to be designated from time to time by the Board of Directors, (said bank or trust company being hereinafter referred to as the "Trustee"), of a sum equivalent to 7¢ for each ton of coal mined and removed during the preceding quarterly period from the properties owned by Pittsburgh Terminal Coal Company before its consolidation with Meadow Lands Coal Company. Said sinking fund so created may be invested in the purchase of said preferred stock at a price not exceeding par in such a manner as the Trustee may deem advisable. If unable to purchase said preferred stock at or below par said fund may be invested by the Trustee, upon instruction from the Board of Directors, in either high grade securities or additional coal lands.

6. Except in the case of the proposed creation and issue of additional preferred stock of equal or superior standing to that already outstanding or of the proposed alteration of the rights or terms of the outstanding preferred stock, the holders of preferred stock shall have no voting powers whatsoever, nor shall they be entitled to notice of any meeting of the stockholders of the corporation, unless and until the corporation shall be in default in the payment of any quarterly dividend on the preferred stock and such default shall have continued for the period of one year. In such case, and thereafter, the holders of the preferred stock shall have the right to receive notice of all meetings of stockholders, and at any such meeting the preferred stock shall, for any and all purposes, have full voting rights; that is to say, the holders of preferred stock shall be entitled to as many votes as they hold shares of such stock upon all questions coming before any meeting of stockholders; and such full voting rights shall continue in the preferred stock until all unpaid accumulated dividends thereon shall have been paid; whereupon, unless and until the corporation shall again be in default as hereinbefore described, the preferred stock shall again be excluded from the right to receive notices of meetings or to vote for any purpose whatsoever. Should any default continue for over two years, then the preferred stock voting as a class shall be entitled to elect one-half the Board of Directors.

7. The preferred stock as an entirety shall be subject to redemption and may be redeemed at the option of the corporation at any time from the date of issue thereof, on any quarterly dividend payment date, by payment, for each share of stock so to be redeemed, of 105% of the par value thereof, and, in addition thereto, of all dividends accumulated and unpaid thereon. Notice of the redemption under this provision shall be given by written notice mailed, not less than sixty (60) days prior to the date fixed for redemption, to the last known address of each record holder of the preferred stock, and by notice published in a newspaper of general circulation in the City of Pittsburgh, Pennsylvania, and in a like newspaper in the City of New York, New York, once a week for six (6) successive weeks prior to said redemption date, the first publication to be not less than sixty (60) days prior to said redemption date.

8. No notes or bonds secured by a mortgage on the real estate of the company may be issued in excess of the amount of presently existing obligations, except for the acquisition of new property, and then only in an amount not in excess of seventy-five per cent. (75%) of the value of the property so acquired, unless, in addition to the vote or consent required of the common stock, if any, at least two-thirds of the outstanding preferred stock shall vote in favor thereof, or consent thereto; provided, however, that the above provision shall not be construed to limit or abridge the right of the corporation, without such consent or vote, to execute purchase-money mortgages or create other purchase-money liens.

For Value Received hereby sell, assign and transfer unto Norma Guttmann

_____ Shares of the Capital Stock represented by the within Certificate, and do hereby irrevocably constitute and appoint _____ Attorney to transfer the said stock on the Books of the within named Company, with full power of substitution in the premises. Dated JAN 15 1937

In Presence of

J. Kelley

Norma Guttmann

L. J. Longuemare

NOTICE: THE SIGNATURE TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME AS WRITTEN UPON THE FACE OF THE CERTIFICATE IN EVERY PARTICULAR WITHOUT ALTERATION OR ENLARGEMENT, OR ANY CHANGE WHATEVER.

THIS SPACE MUST NOT BE COVERED IN ANY WAY

were duly filed by William G. Heiner, Trustee for the Debtor (R. 17, 48), and by various other interested parties, including this respondent, the indenture trustee for the bondholders (R. 11, 30, 47, 51, 52).

After having been twice postponed at the request of the claimants, a hearing to determine the validity of their claims was held before the learned Referee on June 16, 1941. At that hearing the claimants offered in evidence the merger agreement between the Debtor and the Meadow Lands Coal Company, which adds nothing to the case, because all of the provisions contained in said merger agreement applicable to the preferred stock are printed verbatim on the back of the preferred stock certificates (see recital to that effect on face of preferred stock certificate). No other evidence was offered by claimants. At the conclusion of the hearing counsel for the claimants stated that they were not prepared then to argue the law applicable to the case, and accordingly it was agreed that the legal contentions and any other arguments of the parties should be submitted to the Referee in briefs. After briefs had been submitted the claimants on August 5, 1941, again amended their claims as stated above.

An opinion regarding the claims in question and covering all of the questions presented to him was filed by the learned Referee on September 11, 1941 (R. 53-65). In accordance with said opinion orders were entered by the Referee disallowing the claims "without prejudice to the claimants' rights to prove interests as stockholders" (R. 66-69). The claimants petitioned the District Court to review said orders of the Referee (R. 70). After hearing argument and considering briefs, the District Court sustained the decision of the Referee (R. 78-79). The Circuit Court of Appeals affirmed (R. 81-82).

SUMMARY OF ARGUMENT.

In a proceeding under Chapter X of the Bankruptcy Act preferred stockholders may not prove claims as creditors for the par value of their preferred stock plus the accumulated dividends thereon.

ARGUMENT.

I.

Question Decided in Prior Appeal.

The court below, we submit, was correct in holding that the question raised in this appeal was ruled in the prior appeal of substantially the same appellants in *In the Matter of Pittsburgh Terminal Coal Corporation, Debtor,* 109 F. (2d) 1020. That question is whether the holders of preferred stock of the Debtor are creditors of it or stockholders in it. The decision reached in the prior appeal, as expressed in the opinion of the District Court, which was adopted by the Circuit Court of Appeals, was as follows (30 F. Supp. 106 at 107):

> "In the view of the Act, as opposed to general creditors, he [each preferred shareholder] is an owner and as such subordinated to their claims."

In both appeals the real question was or is whether the preferred stockholders are creditors of the Debtor. The fact that the question arises in a different way in each appeal does not affect the answer to the question. If the answer to the question was correct then it remains so now. Then the question arose because three holders of preferred stock of the Debtor filed a petition for the reorganization of the Debtor under Chapter X of the Bankruptcy Act. Such a petition may only be filed by creditors and the question, therefore, was distinctly

raised in the prior appeal whether the preferred stockholders were creditors of the Debtor. Now substantially the same preferred stockholders are seeking to prove "debts" against the Debtor and that the Debtor "is justly and truly indebted to said creditors", meaning the petitioners, for the par value and accumulated dividends of their preferred stock (R. 33-35). The petitioners are, therefore, now expressly taking the position of creditors of the Debtor, which if successful would mean that they would share equally with the bondholders and other acknowledged creditors of the Debtor, except as the preferred stockholders claim a preference to the extent of the amount which would have been in the sinking fund for them if the sinking fund provisions had been maintained. In both instances the claims of the preferred stockholders were founded upon their certificates of preferred stock. Those certificates determine the rights of the petitioners. All of the provisions for the sinking fund and redemption of the preferred stock were before the Court on the prior appeal, because they are all printed on the preferred stock certificates, which were presented as the basis of the claim then as now. Indeed, in their brief (p. 10) in the Circuit Court of Appeals in the prior appeal (No. 7273 in the Circuit Court of Appeals) the appellants quoted the sinking fund provision for the retirement of the preferred stock from the merger agreement between the Debtor and Meadow Lands Coal Company; quoted (p. 18) the whole of paragraph 5 of the endorsements on the preferred stock certificates; and based their argument that they were creditors upon said sinking fund provisions (pp. 10 *et seq.*). In their brief (p. 10) in the prior appeal appellants argued "that by Debtor's violation of the integrity of a contracted sinking fund, the appellants have become creditors", which seems irreconcilable to us with the statement in their brief in support of their petition for *certiorari* (p. 35) that "Their status as creditors

under the sinking fund provision . . . was not before the Court" in the prior appeal. If, as correctly held before, the claimants were not creditors of the Debtor then, they are not now either.

It does not make any difference in the status of the claims whether the Debtor was solvent or insolvent when all or some of the sinking fund payments should have been, but were not, made. It would still be true in either event that the rights of the claimants are defined, and must be determined, by the written instruments on which they are expressly based. Those instruments unmistakably brand the status of the claimants as that of preferred stockholders and not creditors, and the law is well settled as shown by the cases cited in this brief that stockholders, preferred or common, are part owners of the enterprise and may not legally be repaid their capital or undeclared dividends until all creditors have been paid in full. As reference to the photostatic copy of one of the instruments in question which is bound in this brief[4] will show, the instrument certifies that a named person is the owner of a specified number of "shares of the fully paid and non-assessable Preferred capital stock of this Company"; recites that a statement of the preferences, "voting powers", restrictions and other provisions concerning "the six per cent. cumulative preferred stock, and the common stock" appears on the reverse side of the certificate; stipulates that "the holder hereof, by accepting this certificate, assents to and becomes bound by all the provisions therein set forth", which provisions are those printed on the back of the certificate; has in each upper corner on the face thereof "Certificate for less than 100 shares"; has a space entitled "Shares" where the number represented by the certificate is inserted; has printed in large type across the front of it

4. Between pages 4 and 5.

the word "PREFFERED"; has endorsed thereon the usual power of attorney for transferring stock, including the following "For value received .....hereby sell, assign and transfer unto ..... Shares of the Capital Stock represented by the within Certificate and do hereby . . . appoint ..... Attorney to transfer the said stock . . ."; and also has endorsed thereon a full statement of the preferences, voting powers, restrictions and other provisions governing the "preferred stock" and the common stock of the company, which include voting power in the preferred stockholders if their dividends are defaulted and the following: "The holders of the preferred stock of this company shall be entitled to receive, as and when determined and declared by the Board of Directors, dividends at the rate of 6% per annum, and no more, payable quarterly on the first day of each of the months of March, June, September and December of each year for the quarter immediately preceding, from the surplus or net profits of the corporation." All of the above provisions of the instruments in question are manifestly those of stock certificates, and are wholly inconsistent with the instruments being bonds or certificates of indebtedness. The instruments have none of the characteristics of bonds or certificates of indebtedness: they are not designated thereon as either; they do not contain a promise to pay the bearer or a registered owner a definite sum of money on any fixed or determinable date (even the provision for a sinking fund endorsed on the instruments does not specify any time when or within which the preferred stock will be redeemed; the sinking fund is to be used to retire preferred stock when it can be purchased at or below par, or to be invested in other securities "or additional coal lands"); they have no coupons attached to them or provide in any other way for the payment of interest. That the Debtor knew how to issue a bond creating the status of debtor and creditor is apparent

from the fact that the Debtor issued a large bond issue in 1902, of which over $2,500,000 are still outstanding. The former decision that petitioners are merely stockholders and not creditors of the Debtor was, therefore, correct and remains so.

The sinking fund provisions of the preferred stock are valid and enforceable, like the provisions giving preference to dividends on the preferred stock and to its repayment in case of liquidation, as between the preferred and common stockholders, but not against creditors of the corporation. What the preferred stockholders are trying to do now is to assume the status of creditors and thereby have the comparatively small assets of this now undoubtedly insolvent[5] Debtor distributed equally in this proceeding under the Bankruptcy Act *pro rata* among the creditors and the preferred stockholders. Such attempt is contrary to the prior ruling that a holder of the preferred stock of this Debtor "is an owner and as such subordinated to their claims"—meaning by the latter the claims of general creditors.

Even though the Debtor was solvent when the payments into the sinking fund for the preferred stock should have been made, and even though such payments into the sinking fund could then have been made without prejudice to the creditors of the Debtor, upon which allegations of their claims as last amended the petitioners heavily rely, the facts remain (1) that the written instruments which are the fountainhead of their claims establish that the petitioners are stockholders and not creditors and (2) that the petitioners are now seeking to participate at least equally in the assets of the Debtor with its creditors, which is contrary to law. Even if a sinking fund for the preferred stockholders

---

5. See *ante*, pp. 2-3.

existed, which it does not (R. 62), the law would compel that fund to be used to pay off creditors of the corporation before any of it could be paid to stockholders in return of their capital or in payment of accumulated but undeclared dividends. A case in which the security specified and unmistakably earmarked for preferred stockholders actually existed, but in which it was nevertheless held that such fund must be used to pay creditors before any of it could be used to retire preferred stock, is *Ellsworth v. Lyons,* 181 Fed. 55 (C. C. A. 6, 1910). That was a proceeding by preferred stockholders to have appropriated for the retirement of their stock the proceeds of a life insurance policy which the corporation, when solvent, had taken out for the express purpose of securing and retiring the preferred stock. The corporation's by-laws expressly provided that the preferred stock should be retired on a specified date, on which date also the policy matured as an endowment. The by-laws further provided that the money received from the insurance policy "shall be used for no other purpose whatsoever than the retirement of the preferred stock." Notwithstanding said clearly expressed intent, the courts held that said insurance proceeds must be used to pay the claims of the corporation's creditors and that the preferred stockholders had no right to receive any part of said insurance money—and this notwithstanding that the claims of the creditors had arisen subsequent to the issuance of said preferred stock and the taking out of said insurance policy. The following are extracts from the opinion (p. 58):

> "It is equally well settled that a contract between a corporation and a stockholder by which the latter is to receive the par value or any part of his stock before all corporate debts are paid is contrary to public policy, and void." (Citing cases)

(p. 61):

"It is true that the agreement in question attempted to secure the preferred stockholders, but that, as shown by the authorities cited, is incompetent as against creditors prior or subsequent, and is the vice of the situation."

Ellsworth v. Lyons, supra, has been cited approvingly by the Supreme Court of Pennsylvania in *Moy v. Colonial Finance Corp.,* 283 Pa. 323, 326, 129 A. 115, and *Mitchell, Receiver of Liberty Clay Products Co.,* 291 Pa. 282, 290, 139 A. 853.

If preferred stockholders cannot enforce a trust upon a fund which actually exists and which was raised for the specific purpose of retiring the preferred stock, *a fortiori* they cannot have a trust declared in a non-existent fund of the amount that the corporation had agreed with the preferred stockholders it would pay into a sinking fund for their security, and it is wholly immaterial as between the preferred stockholders and creditors of the corporation that the corporation promised the preferred stockholders to create a sinking fund for them or whether the corporation was solvent at the times when the payments should have been deposited in the sinking fund if the promise had been kept.

The terms of the preferred stock issue of the Debtor remain as when they were previously before the Court below and there is no additional circumstance shown by the present record which takes the case out of the former decision of that Court that the claimants are not creditors of the Debtor.

II.

Bankruptcy Act Definition.

The Bankruptcy Act, § 106, Chapter X, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 883 (11 USCA § 506) defines a "creditor" as "the holder of any claim" and a claim as "all claims of whatever character against a debtor or its property, except stock . . ."

The Bankruptcy Act itself, therefore, clearly excludes the petitioners from the position of creditors, because their claims are expressly based upon certificates of preferred stock (R. 34, 42, 44). It was so held in the prior appeal of these same parties: 30 F. Supp. at 107.

While there appear to be no other rulings than the former one in this same matter which construed the language of the Bankruptcy Act as amended by the Chandler Act in 1938, there are cases construing substantially the same definitions in the former § 77B, which was superseded by the Chandler Act—all of which cases are in accord with the decision below: *In re Piccadilly Realty Co.,* 78 F. (2d) 257, 261 (C. C. A. 7, 1935); *Bryan v. Welch,* 74 F. (2d) 964, 971 (C. C. A. 10, 1935); *In re Arcadia Furniture Co.,* 12 F. Supp. 477, 478 (1935). In the *Piccadilly Realty Co.* case, *supra,* the court concluded as follows (p. 261):

> "* * * * therefore matured corporate promises to retire or pay corporate stock cannot be considered corporate debts in a proceeding under 77B."

III.

Pennsylvania Law.

The Pennsylvania law is firmly established to be that preferred stockholders of a corporation occupy a subordinate position to that of creditors and cannot legally receive any part of the corporate assets on account of the par value of their stock or undeclared dividends unless and until corporate creditors are paid in full.

Section 705 of the Pennsylvania Business Corporation Law of 1933, P. L. 364, 15 P. S. § 2852-705, provides in part as follows:

> "No redemption of shares shall be made which will reduce the remaining assets of the corporation below an amount sufficient to pay all debts and known liabilities of the corporation as they mature, except such debts and liabilities as have been otherwise adequately provided for, . . ."

Section 302 of said Pennsylvania Business Corporation Law defines the general powers of business corporations, the seventh of them being as follows, 15 P. S. § 2852-302 (7):

> "To purchase, take, receive, or otherwise acquire, hold on pledge, transfer, or otherwise dispose of its own shares, except that no such purchase or acquisition shall be made at a time when the net assets of the corporation are less than its stated capital, or which would reduce its net assets below its stated capital."

Warren v. Queen & Co., 240 Pa. 154, 87 A. 595 (1913), is probably the leading Pennsylvania case on

the relative rights of creditors and preferred stockholders. That was an action of assumpsit by a preferred stockholder against his company to recover the par value of his preferred stock, based upon a stipulation printed on his certificate that "The shares represented by this certificate shall be redeemed by the Company on March 1, 1911, at par." The corporation filed an affidavit of defense alleging that it did not have the funds or property to redeem the preferred stock and also pay its current expenses and creditors. The plaintiff moved for judgment for want of a sufficient affidavit of defense (in effect demurred to the affidavit of defense). The affidavit of defense was held to state a valid defense. After holding that the Pennsylvania corporation statutes then in effect, which did not differ in this respect from the Pennsylvania Business Corporation Law now in effect, subordinated stockholders to creditors, the Supreme Court of Pennsylvania continued as follows (pp. 160-161):

> "Aside from the Act of 1873, it would be against public policy to permit a preferred stockholder to assert his claim as such against the funds of a corporation in preference to the claims of creditors. The stock of a corporation is its capital, and is responsive to the claims of its creditors. It is held in trust for the payment of the indebtedness of the corporation. The relation of a stockholder and a creditor to a corporation is not at all alike, but entirely different. A certificate of stock does not make the holder a creditor as well as a stockholder. A stockholder cannot be both a creditor and a debtor by virtue of his ownership of stock: Warren v. King, 108 U. S. 389, 399. The stock is part of the capital of the corporation which the holder cannot withdraw until its indebtedness is paid. The preferred stockholder is but a stockholder with a right

to have his dividend paid before dividends on the common stock are paid, and he is not entitled to any dividend until the corporation has funds which are properly applicable to the payment of dividends: 1 Cook on Corp., Sec. 271. He has the right to the dividends on his shares to the extent authorized by his certificate in preference to the holder of common stock, but beyond this he has no right superior to the holder of common stock, and both hold their stock subject to the payment of the indebtedness of the corporation. This is the settled rule recognized in all jurisdictions. A corporation has no right to make any rules by which the holder of stock, common or preferred, may be preferred in the liquidation of its assets over the creditors of the company. In speaking of the rights of the holders of preferred stock, LURTON, J., in Hamlin v. Toledo, Etc., R. R. Co., 78 Fed. Repr. 664, 671, says: 'If the purpose in providing for these peculiar shares (of preferred stock) was to arrange matters so that, under any circumstances, a part of the principal of the stock might be withdrawn before the full discharge of all corporate debts, the device would be contrary to the nature of capital stock, opposed to public policy, and void as to creditors affected thereby.' A contract that dividends shall be paid on preferred stock whether any profits are made or not is contrary to public policy and void: Pittsburgh & Connellsville R. R. Co. v. Allegheny County, 63 Pa. 126; Pittsburgh & Steubenville R. R. Co. v. Allegheny County, 79 Pa. 210. An agreement to pay dividends absolutely and at all events—from the profits when there are any, and from the capital stock when there are not—is an undertaking which is contrary to law and is void: 1 Cook on Corp., Sec. 271. Public policy, it is said, condemns with

emphasis any such undertaking on the part of a corporation as to its preferred or guaranteed stock.

We are of opinion that the instrument in suit is a certificate of stock and not an instrument in writing for the payment of money, and that the plaintiff as the holder of such certificate cannot recover the principal of the stock until the indebtedness of the corporation is liquidated."

Other Pennsylvania cases in accord with the proposition that a person cannot, by virtue of any corporate undertaking to secure or redeem his stock, enjoy the advantages of an owner of the business in prosperous times and shift to the position of creditor when the corporation is in the throes of financial embarrassment are *Culver v. Reno Real Estate Co.*, 91 Pa. 367, 375; *Moy v. Colonial Finance Corp.*, 283 Pa. 323, 326, 129 A. 115; and *Mitchell, Receiver of Liberty Clay Products Co.*, 291 Pa. 282, 290, 139 A. 853.

The Pennsylvania cases cited by the claimants are not in point. In *Wolf v. Excelsior Scale & Supply Co.*, 270 Pa. 547, 113 A. 569, it expressly appears that the corporation had no creditors (see 270 Pa. at 550). *Smith v. Citizens Ins. & Mtg. Co.*, 284 Pa. 380, 131 A. 191, was a suit to rescind a stock subscription which had been improperly obtained, and in no way involved creditors. *Peoples-Pittsburgh Trust Co. v. Pittsburgh United Corp.*, 338 Pa. 328, 12 A. (2d) 430, turned upon an agreement, known as the Schiller agreement, wholly independent of the preferred stock certificates and when the Schiller agreement became effective "the certificates", as the court said (p. 335), "dropped out of the transaction." The court in that case said with reference to *Warren v. Queen & Co., supra* (p. 335), "There is no doubt of the validity of that decision", thereby demonstrating that

Warren v. Queen & Co. still is good law in Pennsylvania, where, as in the case at bar, the claimant is relying upon a preferred stock certificate for his status of a creditor.

IV.

Federal Law.

The federal law is also well established to be that a holder of preferred stock is not a creditor and that neither his capital nor undeclared dividends thereon can legally be collected by him until all corporate creditors have been paid in full. *Warren v. King,* 108 U. S. 389 (1883), is probably the leading case in the whole country on the subject at hand. This Court in that case said (p. 396):

> "The rights of the holders of preferred stock in this case must be determined by the language of the stock certificate. . . . But it is stock, and part of the capital stock, with the characteristics of capital stock. One of such characteristics is, that no part of the property of a corporation shall go to reimburse the principal of capital stock until all the debts of the corporation have been paid."

Other federal cases in accord are *Hamlin v. Toledo, etc., R. R. Co.,* 78 Fed. 664, 670-671 (C. C. A. 6); *Guaranty Trust Co. v. Galveston City R. Co.,* 107 Fed. 311, 318 (C. C. A. 5); *Spencer v. Smith,* 201 Fed. 647, 652 (C. C. A. 8); *Hazel Atlas Glass Co. v. Van Dyk & Reeves, Inc.,* 8 F. (2d) 716, 719 (C. C. A. 2); *In re Hicks-Fuller Co.,* 9 F. (2d) 492, 493-494 (C. C. A. 8); *Curtis v. Dade County Security Co.,* 30 F. (2d) 325, 326 (C. C. A. 5); *Vanden Bosch v. Michigan Trust Co.,* 35 F. (2d) 643, 645 (C. C. A. 6); *Mathews v. Bradford,* 70 F. (2d) 77,

78-79 (C. C. A. 6); and *In re Phoenix Hotel Co.*, 83 F. (2d) 724, 726 (C. C. A. 6).

In the last of those cases the law is well summarized as follows (83 F. (2d) at 726):

> "It is a fundamental rule of corporation law that one cannot be at the same time both a stockholder and a creditor of a corporation in respect to the same funds hazarded in the corporate enterprise. The two relations are antipodal. This principle is not only rooted in sound public policy, but grows out of the very nature of corporations. The assets represented by corporate stock are the basis of its credit, and provide a fund for the payment of its debts. No part of them may be withdrawn for the purpose of retiring shares until debts are paid."

In conclusion, it is respectfully submitted that the instruments on which the claims are expressly founded clearly show that the petitioners are not creditors but only preferred stockholders of the Debtor, and that as such the petitioners are not entitled to prove claims as creditors for the par value of their stock plus the accumulated dividends thereon or any part thereof. If the claims are rejected in *toto*, as seems so clearly right, there is no need to consider whether any part of the claims is entitled to a preference because of any hypothetical sinking fund. The claims recite that the claimants' stock was purchased "through open market transactions" (R. 34, 44). If judicial notice can be taken of the quotations of the New York Stock Exchange, it will be seen that the Debtor's preferred stock in the boom year 1929 sold at a high of $34\frac{3}{8}$ and that its high between January 1, 1930 and December 2, 1938, when it was delisted, was $15\frac{7}{8}$. While it does not appear

when the petitioners purchased their stock, it would appear probable that the allowance of their claims would be an anomalous windfall. The opinions of the learned Referee and of the Courts below are correct and should be sustained. Accordingly, the writ of *certiorari* should be denied.

Respectfully submitted,

WILLIAM H. ECKERT,
Attorney for The Union Trust Company of Pittsburgh, Successor Trustee for Bondholders of the Debtor.